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C O N F I D E N T I A L ROME 004053

SIPDIS

E.O. 12958: DECL: 08/19/2007

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SUBJECT: KEY ECONOMIC POLICY-MAKERS ON GOI BUDGET ISSUES

REF: A. A: ROME 2794

CONFIDENTIAL

PAGE 02 ROME 04053 01 OF 03 200811Z

[1](#)B. B: ROME 3551

CLASSIFIED BY: ACTING ECONOMIC COUNSELOR KATHLEEN DOHERTY FOR REASONS 1  
.5 (B) AND (D)

[1](#)1. (SBU) SUMMARY. THE BALLOONING PUBLIC DEFICIT IS A MATTER OF GREAT CONCERN TO THE GOI, SEVERAL KEY ECONOMIC POLICYMAKERS TOLD ECONOMIC COUNSELOR DURING A SERIES OF RECENT MEETINGS. DEPUTY FINANCE MINISTER MARIO BALDASSARRI, FINANCE MINISTRY UNDER SECRETARY VITO TANZI, AND SENIOR RESEARCHER AT THE BANK OF ITALY DANIELE FRANCO EXPRESSED CONCERN ABOUT THE PUBLIC DEFICIT, WHICH IS LIKELY TO EXCEED THE 2002 TARGET OF 1.1 PERCENT. THE GOI FACES MOUNTING EXPENDITURES FOR HEALTH AND EDUCATION. PENSION AND INTEREST PAYMENTS CANNOT BE CUT. SECURITY AND DEFENSE COSTS HAVE PUSHED UP THE DEFICIT. AT THE SAME TIME, THE GLOBAL ECONOMIC SLOWDOWN HAS PUSHED TAX REVENUES BELOW EXPECTATIONS. FINANCE MINISTER TREMONTI HAS CHOSEN TO DELAY MEETING STABILITY PACT TARGETS FOR TWO YEARS TO ENCOURAGE ECONOMIC GROWTH. HE PLANS TO CUT TAXES AND INVEST IN NEEDED INFRASTRUCTURE, WHILE EXERTING TOUGH PRESSURE ON OTHER GOVERNMENT SPENDING. END SUMMARY.

THE GOVERNMENT,S FIRST YEAR  
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[1](#)2. (SBU) THE MEETING WITH BALDASSARRI TOOK PLACE A FEW DAYS AFTER THE APPROVAL OF THE DPEF, THE 2002-2006 GOI BUDGET PLAN. BALDASSARRI SAID THAT THE GOI HAD FACED DIFFICULT ECONOMIC CIRCUMSTANCES IN ITS FIRST YEAR. HE MENTIONED THAT GOVERNMENT EFFORTS TO JUMP-START ECONOMIC GROWTH HAD BEEN  
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PAGE 03 ROME 04053 01 OF 03 200811Z  
UNDERMINED BY THE 2001 DEFICIT INHERITED FROM THE PREVIOUS ADMINISTRATION, USD 18 BILLION DOLLARS LARGER THAN EXPECTED, AND ECONOMIC REVERBERATIONS FROM SEPT. 11. THE INHERITED DEFICIT AND THE ECONOMIC SLOWDOWN TOGETHER FORCED FINANCE MINISTER TREMONTI TO POSTPONE PLANS FOR TAX CUTS.

[1](#)3. BALDASSARRI EXPLAINED THAT THE WORSENING INTERNATIONAL OUTLOOK FOLLOWING SEPT. 11 SLOWED THE ITALIAN GROWTH RATE FROM 2.3 PERCENT TO 1.3 PERCENT IN 2001, AND TO THE LIKELY ONE PERCENT OR LOWER IN 2002. TO STIMULATE GROWTH IN 2003, THE GOI PLANS TO IMPLEMENT THE FIRST PART OF PLANNED TAX CUTS -- CUTTING TAXES FOR LOWER INCOME LEVELS.

2002 PUBLIC FINANCE TRENDS  
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[1](#)4. (SBU) ON AUGUST 1, ECONOFFS MET WITH DANIELE FRANCO, CHIEF OF THE PUBLIC FINANCE DIVISION OF THE RESEARCH DEPARTMENT OF THE BANK OF ITALY. FRANCO WAS ALSO PESSIMISTIC ABOUT PUBLIC FINANCE TRENDS IN 2002. THE PUBLIC DEFICIT GREW FASTER IN THE FIRST HALF OF THIS YEAR THAN IN CORRESPONDING PERIOD LAST YEAR. THE PUBLIC DEFICIT WAS E31.1 BILLION THROUGH JULY 2002, UP 29 PERCENT OR 7 BILLION EURO OVER THE CORRESPONDING PERIOD IN 2001. FRANCO POINTED TO THE SAME PROBLEMS AS HAD THE FINANCE MINISTRY OFFICIALS -- THE ECONOMIC SLOWDOWN HAD MEANT LOWER REVENUES, WHILE GOVERNMENT SPENDING HAD EDGED UP, PARTICULARLY IN THE AREA OF HEALTH CARE. DEEP STRUCTURAL REFORMS WERE STILL NEEDED -- INCLUDING TAX REFORM AND PENSION REFORM. FRANCO ADDED THAT THE GOI'S PROBLEMS HAD BEEN COMPLICATED BY AN EUROSTAT DECISION TO REVISE THE 2001 PUBLIC DEFICIT FIGURE UPWARDS TO 2.2 PERCENT OF GDP. EUROSTAT HAD  
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PAGE 04 ROME 04053 01 OF 03 200811Z  
DISAGREED WITH THE GOI'S ACCOUNTING FOR SECURITIZED REVENUES FROM LOTTERY PROCEEDS AND REAL ESTATE SALES.

[1](#)5. (SBU) FRANCO NOTED THAT THE GOI HAD GENERATED EURO 50 MILLION TO DATE FROM A MEASURE ALLOWING ITALIANS TO REPATRIATE CAPITAL HELD OVERSEAS (AND NOT DECLARED FOR TAX PURPOSES) IN RETURN FOR A ONE-TIME 2.5 PERCENT PENALTY. NONETHELESS, HE PREDICTED THAT THE 1.1 PERCENT DEFICIT/GDP TARGET FOR 2002 WOULD BE EXCEEDED.

2003 BUDGET  
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16. (SBU) BOTH TANZI AND BALDASSARI STRESSED THAT THE GOI FACES INTENSE PRESSURE TO BRING THE 2003 BUDGET DEFICIT DOWN. WHILE FINANCE MINISTER TREMONTI HAD POSTPONED BALANCING THE BUDGET TO 2005 (FROM 2003), HE REMAINS FIRMLY COMMITTED TO KEEPING THE DEFICIT TO A MINIMUM. AT THE SAME TIME, TREMONTI AND PRIME MINISTER BERLUSCONI HAVE PROMISED TAX CUTS AND NEW INVESTMENT IN INFRASTRUCTURE. GIVEN THESE CONSTRAINTS, TREMONTI IS SEEKING TO CUT WHEREVER POSSIBLE AND TO CAP SPENDING IN ALL MINISTRIES.

17. (U) FINANCE U/S TANZI EXPLAINED THAT HE HAD FOUND HIMSELF

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CONFIDENTIAL PTQ6101

PAGE 01 ROME 04053 02 OF 03 200812Z  
ACTION EUR-00

INFO	LOG-00	NP-00	AGRE-00	AID-00	CEA-01	CIAE-00	COME-00
	CTME-00	INL-00	DODE-00	DOEE-00	DOTE-00	ANHR-00	SRPP-00
	EB-00	EXIM-01	E-00	FAAE-00	VC-00	FRB-00	H-01
	TEDE-00	INR-00	ITC-01	LAB-01	L-00	VCE-00	MMP-00
	AC-01	NSAE-00	NSCE-00	OIG-03	OMB-01	OPIC-01	ACE-00
	SP-00	SSO-00	SS-00	STR-00	USIE-00	LBA-00	DRL-02
	G-00	NFAT-00	SAS-00	/013W			

-----DB64DF 200813Z /38

P 200738Z AUG 02  
FM AMEMBASSY ROME  
TO SECSTATE WASHDC PRIORITY 5459  
INFO EU MEMBER STATES COLLECTIVE PRIORITY  
AMCONSUL FLORENCE PRIORITY  
AMCONSUL FRANKFURT PRIORITY  
AMCONSUL MILAN PRIORITY  
AMCONSUL NAPLES PRIORITY  
DEPT OF TREASURY WASHDC PRIORITY  
USEU BRUSSELS PRIORITY 2792  
DEPT OF LABOR WASHDC PRIORITY

C O N F I D E N T I A L SECTION 02 OF 03 ROME 004053

SIPDIS

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SUBJECT: KEY ECONOMIC POLICY-MAKERS ON GOI BUDGET ISSUES

FAR MORE CONSTRAINED THAN HE HAD EXPECTED IN CUTTING  
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PAGE 02 ROME 04053 02 OF 03 200812Z  
GOVERNMENT SPENDING. MUCH OF THE SPENDING SIMPLY CANNOT BE CUT. POST-SEPTEMBER 11 SECURITY SPENDING AND MILITARY SPENDING FOR OPERATION ENDURING FREEDOM HAD BEEN COSTLY, BUT ESSENTIAL. PENSION PAYMENTS ABSORB A TOTAL 18 PERCENT OF THE BUDGET, HEALTH SPENDING SIX PERCENT, EDUCATION AND OTHER SOCIAL SPENDING 12 PERCENT AND INTEREST ON ITALY,S FOREIGN DEBT ANOTHER 13 PERCENT.

18. (U) THE HEALTH SECTOR REFORM, ADOPTED IN LATE 2001 AS PART OF ITALY'S DEVOLUTION OF AUTHORITY TO THE REGIONAL GOVERNMENTS, HAS NOT CONTAINED GOVERNMENT HEALTH SPENDING AS PREDICTED. WHEN MANAGEMENT OF HEALTH CAR WAS DEVOLVED TO THE REGIONAL GOVERNMENTS, ALONG WITH THE FUNDING, TOTAL EXPENDITURES WERE CAPPED AT 6 PERCENT OF GDP. HOWEVER, THE REGIONS HAVE (PARTICULARLY IN THE SOUTH) SPENT MORE THAN ALLOWED. THE GOI IS LEGALLY FORBIDDEN TO SIMPLY DENY HEALTH CARE TO ITALIAN CITIZENS, AND THUS MUST PROVIDE THE ADDITIONAL FUNDING REQUIRED. THE 2003 BUDGET LAW WILL, THEREFORE, HAVE TO INCLUDE ADDITIONAL FUNDING FOR HEALTH CARE. TANZI NOTED THAT THE RISING COST OF HEALTH IS ONE OF THE MOST SERIOUS CONCERNS TO THE FINANCE MINISTRY.

19. (U) THE 2003 BUDGET IS TIGHT, NOTED BALDASSARI, BUT INCLUDES SEVERAL ELEMENTS INTENDED TO SPUR ECONOMIC GROWTH.

1A. IMPLEMENTATION OF THE FIRST TRANCHE OF THE TAX REFORM, WHICH WILL BENEFIT LOWER INCOME FAMILIES, WHO ALSO ARE THOSE MOST AFFECTED BY THE PRICE INCREASES RELATED TO THE EURO CHANGEOVER. (DANIELE FRANCO OF THE BOI PREDICTED THAT THIS FIRST ROUND OF TAX CUTS WOULD COST SLIGHTLY OVER ONE PERCENT OF GDP.)

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PAGE 03 ROME 04053 02 OF 03 200812Z

1B. A LABOR PACT MADE WITH EMPLOYERS, REPRESENTATIVES AND THE MAIN TRADE UNION CONFEDERATIONS. (NOTE: THE PACT DOES NOT INCLUDE CGIL, THE LARGEST UNION IN TERMS OF MEMBERSHIP AND WHICH OPTED OUT OF THE PACT.) THE MOST IMPORTANT MEASURES OF THE PACT ARE THE 36-MONTH SUSPENSION OF ARTICLE 18 OF THE LABOR STATUTE FOR THOSE NEWLY HIRED IN COMPANIES WITH FEWER THAN 15 WORKERS, AND AN EXTENDED PAYMENT PERIOD OF UNEMPLOYMENT BENEFITS. (REF A PROVIDES BACKGROUND ON ARTICLE 18 AND THE LABOR PACT.)

1C. IMPLEMENTATION OF AN AMBITIOUS INFRASTRUCTURE INVESTMENT PROGRAM (SEE PARA 12).

110. (SBU) BALDASSARRI SAID THAT THE FINANCE MINISTRY HAS REDUCED ITS OWN COSTS FOR PROCURING GOODS AND SERVICES BY ONE-THIRD IN 2002, BY CREATING "CONSIP", WHICH HAS IMPLEMENTED A PROGRAM OF ON-LINE PURCHASING. IN 2003, THE GOI WILL EXPAND ON-LINE PURCHASES OF GOODS AND SERVICES, THROUGH CONSIP, WHICH IS EXPECTED TO REDUCE THESE EXPENDITURES BY AT LEAST 10 PERCENT -- A SAVINGS OF 40-50 MILLION EURO.

A NEW TAX? AN AMNESTY?

111. (C) U/S TANZI (PROTECT) MENTIONED THAT THERE WERE TWO MORE MEASURES UNDER SERIOUS CONSIDERATION FOR THE 2003 BUDGET: A ONE-TIME TAX AND A TAX AMNESTY. TANZI SAW PROBLEMS WITH BOTH. A ONE-TIME TAX WOULD RAISE SOME REVENUE, BUT WOULD BE AN UNPOPULAR MEASURE. IT WOULD BE HARSHLY  
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PAGE 04 ROME 04053 02 OF 03 200812Z  
CRITICIZED AS A BREAKING OF PRIME MINISTER BERLUSCONI'S PROMISE TO CUT TAXES. THE PROPOSED AMNESTY FOR TAX EVADERS (PERMITTING THEM TO PAY A ONE-TIME PENALTY AND RETURN TO THE TAX SYSTEM) WOULD, IN TANZI'S OPINION, BE EVEN WORSE. TAX PARDONS, HE ARGUED, ARE NEGATIVE BECAUSE THEY CREATE EXPECTATIONS FOR FURTHER TAX PARDONS IN THE FUTURE AND LEAD TO FURTHER EVASION. MOREOVER, THEY ANGER LAW-ABIDING TAXPAYERS.

INFRASTRUCTURE

112. (SBU) THE 2003 BUDGET WILL INCLUDE AN INVESTMENT PROGRAM FOR PUBLIC SECTOR INFRASTRUCTURE ) ROADS PRIMARILY. TANZI ACKNOWLEDGED THAT IMPROVEMENTS IN INFRASTRUCTURE ARE A LONG-TERM GOI PROJECT; IN THE SHORT TERM, NO EFFECT ON GDP GROWTH IS EXPECTED.

113. (SBU) DEPUTY MINISTER BALDASSARRI BELIEVES THAT THE GOI'S NEWLY CREATED COMPANY, INFRASTRUTTURA S.P.A., WILL ENSURE THAT INFRASTRUCTURE PROJECTS ARE DONE IMPLEMENTED ACCORDING TO PRIORITY AND ON A TIMELY BASIS. INFRASTRUTTURA S.P.A. WILL HELP FINANCE INFRASTRUCTURE AND PUBLIC WORK PROJECTS BY ISSUING BONDS. BALDASSARRI DOWNPLAYED THE IMPACT ON THE PUBLIC

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CONFIDENTIAL PTQ6103

PAGE 01 ROME 04053 03 OF 03 200812Z  
ACTION EUR-00

INFO	LOG-00	NP-00	AGRE-00	AID-00	CEA-01	CIAE-00	COME-00
	CTME-00	DODE-00	DOEE-00	DOTE-00	ANHR-00	SRPP-00	EB-00
	EXIM-01	E-00	FAAE-00	VC-00	FRB-00	H-01	TEDE-00
	INR-00	ITC-01	LAB-01	L-00	VCE-00	MMP-00	AC-01
	NSAE-00	NSCE-00	OIG-03	OMB-01	OPIC-01	ACE-00	SP-00
	SSO-00	SS-00	STR-00	USIE-00	LBA-00	DRL-02	G-00
	NFAT-00	SAS-00	/013W				

-----DB64E3 200813Z /38

P 200738Z AUG 02  
FM AMEMBASSY ROME  
TO SECSTATE WASHDC PRIORITY 5460  
INFO EU MEMBER STATES COLLECTIVE PRIORITY  
AMCONSUL FLORENCE PRIORITY  
AMCONSUL FRANKFURT PRIORITY  
AMCONSUL MILAN PRIORITY  
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DEPT OF TREASURY WASHDC PRIORITY  
USEU BRUSSELS PRIORITY 2793  
DEPT OF LABOR WASHDC PRIORITY

C O N F I D E N T I A L SECTION 03 OF 03 ROME 004053

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DEFICIT. SOME BONDS ARE EXPECTED TO BE BACKED BY THE SALE OF  
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PAGE 02 ROME 04053 03 OF 03 200812Z  
GOI REAL ESTATE. THE GOI HOPES THAT SUCH SALES WILL GENERATE INCOME EQUAL TO FIVE PERCENT OF GDP.

114. (U) THE BOI'S FRANCO NOTED THAT THE BUDGET DOCUMENT DPEF 2003-2006 ASSUMES INVESTMENT IN INFRASTRUCTURE WILL EQUAL FIVE PERCENT OF GDP EACH YEAR. FRANCO DOUBTS THAT GOI WILL BE ABLE TO FINANCE THIS LEVEL OF INFRASTRUCTURE INVESTMENT FROM PRIVATE FINANCING ALONE.

PRIVATIZATIONS  
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15. (U) ACCORDING TO BALDASSARI, THE BERLUSCONI GOVERNMENT PLANS TO ACCELERATE PRIVATIZATIONS DURING 2003, IF MARKET CONDITIONS IMPROVE. THE FIRST TO BE SOLD WILL BE THE GOI'S TOBACCO MANUFACTURING COMPANY ETI. FURTHER ASSETS OF THE GOI ELECTRICITY COMPANY ENEL WILL ALSO BE AUCTIONED IN 2003. THE GOI INTENDS TO SELL ALL BUT 30 PERCENT OF ENEL AND THE HYDROCARBONS FIRM ENI. BALDASSARI SAID THAT THERE WERE PLANS TO SELL OFF THE GOI'S RAILWAYS AND THE POSTAL SERVICE, BUT NOT IN THE NEAR TERM. HE ADDED THAT THERE ARE NO PLANS TO PRIVATIZE THE NATIONAL TV NETWORK, RAI.

COMMENT  
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16. (SBU) THE GOI'S EXPERT FINANCE MINISTRY TEAM IS CLEARLY CONCERNED OVER THE FISCAL OUTLOOK. NONETHELESS, FINANCE MINISTER TREMONTI HAS CHOSEN TO MOVE AHEAD WITH ESSENTIAL INFRASTRUCTURE INVESTMENT AND TAX CUTS. WHILE THIS MAY DELAY ELIMINATION OF ITALY'S FISCAL DEFICIT, IT IS ESSENTIAL TO THE  
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PAGE 03 ROME 04053 03 OF 03 200812Z  
ECONOMIC GROWTH OF THE COUNTRY. TREMONTI'S CREDIBILITY AND COMPETENCE ARE THE KEY ASSETS OF THE GOI AS IT FACES THE ECONOMIC STORMS AHEAD.  
SKODON

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